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MASTER SETTLEMENT AGREEMENT
(Financial Provisions)

Background
In 1998, the Attorneys General of 46 states, including Oregon, signed the Master Settlement Agreement (MSA) with the four largest tobacco companies in the United States. The MSA settled state suits to recover costs associated with treating smoking-related illnesses, among various other claims, including antitrust, consumer protection and racketeering. MSA payments to the settling states are made in perpetuity.

The MSA distinguishes among several types of cigarette manufacturers, including:

Original Participating Manufacturers (**OPM's**) - Philip Morris, Brown & Williamson, Lorillard, and RJ Reynolds
Subsequent Participating Manufacturers (**SPM's**) - manufacturers that have singed onto MSA, and
Non-Participating Manufacturers (**NPM's**) - manufacturers that have not signed onto MSA.

The MSA provides financial incentives for settling states to enact and diligently enforce a qualifying statute. A qualifying statute is one that requires NPM's to establish and fund an escrow account for sales of cigarettes in a settling state. Required payments are roughly equivalent to those required by MSA. These funds may be spent only to pay claims arising from future litigation against these companies and are returned to the NPM's on a rolling basis in 25 years, in the absence of a state claim. All 46 states have enacted qualifying statutes (Oregon's is ORS 296.530, et seq).

The MSA requires three types of payments by participating manufacturers before adjustments, offsets and reductions:

Initial and Subsequent Initial Payments - in January 1998 and 2000 through 2003 ($12.7 billion)
Annual Payments - in April 2000 and continuing indefinitely ($207.9 billion through 2025)
Strategic Contribution Payments - in April 2008 through 2017 ($8.6 billion).

Payments by participating manufacturers go into a national escrow account and are subsequently distributed to the states with Oregon receiving 1.147% of the initial and annual payments. The strategic contribution payment is fixed for each state. The payment for Oregon is $208 million over ten years before adjustments, offsets and reductions or roughly 2.4% of the national payment.

There are a number of potential adjustments, offsets and reductions to these payments, which are contingent upon certain actions by the parties, by the federal government, or by changes in the demand for tobacco products. Many of these potential adjustments, offsets and reductions make the payment stream less certain but their impact cannot reasonably be anticipated. Of particular importance are the following:

- Non-Participating Manufactures Adjustment. All payments are subject to this adjustment on a state by state and year by year basis. If an independent entity determines that the market share of the OPM's and SPM's declined by more than 2% because the MSA was a "Significant Factor" contributing to the market share loss and that a state has not "Diligently" enforced the qualifying statute, payments to a state will be reduced by 3 times the market share reduction in that state.

- Litigating Releasing Party Offset. In general, the MSA requires the states to release all future claims against participating manufacturers. If a participating manufacturer pays a qualifying claim (released claim) to a settling state, the annual payments are offset dollar for dollar.

The following three adjustments are estimated and apply to some or all of the payments:

- Inflation Adjustment. Annual payments (OPM's only) and strategic contribution payments are increased by the larger of 3% or the U.S. CPI for the prior year
- Volume Adjustment. Initial, annual and strategic contribution payments are adjusted for any decrease in sales by OPM's. The ratio of prior year's sales to 1997 sales is computed each year. The volume adjustment is 98% of this ratio. This reflects both smoking cessation and declining market share of the OPM's.
- Previously Settled States Reduction. Annual payments are reduced by roughly 12%. This result from previous settlements with 4 states that are not parties to MSA.

Estimated MSA Payments

The MSA specifies the amount of the payments, before adjustments, offsets and reductions, to be made by the OPM's and the basis for determining payments by SPM's before adjustments, offsets and reductions. Actual payments depend on the adjustments discussed above and are estimated in the table below. Payments to Oregon's include 1.147% of the initial and annual payments plus the strategic contribution payment determined for Oregon.

Estimated Master Settlement Payments in Millions of Dollars

	National Payments into Escrow				
Period*	Initial Payment	Annual Payment	Oregon's Share	Strategic Payment	Total Oregon
By 6/30/2002	8,824.4	12,493.4	257.6**	-	257.6**
2002-03	2,104.7	4,990.1	81.4	-	81.4
2003-07	-	6,121.9	70.3	-	70.3
2007-17	-	6,642.4	76.2	19.3	95.6
2017-25	-	8,145.4	93.5	-	93.5

* Annual average for multiple fiscal years after 2002-03. ** Actual receipts plus earnings.

Use of MSA Payments

The MSA places no restrictions on how the states use the MSA payments and there is wide variation among the states. The 1999 Legislature referred HB 2007 to the people (M89) at the 2000 General Election. Measure 4 was put before the people at this same election by initiative petition. Both would have dedicated MSA payments, both were defeated. As a result, the first appropriation of these payments was by the 2001 Legislature. After adjustments by the 2002 Special Sessions, the Legislature appropriated (millions): $209.0 for the Health Plan, $99.2 to the General Fund, $20.0 for Family Health Insurance Assistance, and $5 for OHSU. Up to $100 million of any payments received during this biennium in excess of these appropriations goes to the Health Care Trust Fund and any additional amount would accrue as an ending balance in the Tobacco Settlement Funds Account. The estimated revenue for the biennium implies a transfer of $5.9 to the Health Care Trust Fund. The 2001 Legislature also passed SB 832, which directs DAS to transfer MSA payments to the OHSU Bond Fund as needed for debt service on up to $200 million in General Obligation bonds ($100 million has been approved by the Emergency Board). Debt service is estimated at $15.8 million per year for 20 years but none is expected before July 1, 2003.

The Fifth 2002 Special Session passed HB 4073, which creates the Master Settlement Asset Corporation as a semi-public corporation with a board of directors including the State Treasurer as board chairperson and two members of the public appointed by the Treasurer. The Department of Administrative Services (DAS) is directed to sell a portion of the MSA payment stream to the corporation in exchange for $150 million in net proceeds from bonds to be issued by the corporation and any residual interest. Residual interest is any excess of MSA payments sold to the corporation over amounts needed by the corporation to pay bond related costs and the corporation's operating costs. Operating costs are defined to include the Attorney General's cost of enforcing the qualifying statute. The $150 million in net proceeds is to be transferred to DAS by May 1, 2003 and subsequently transferred to the State School Fund for grants to schools. The Legislature may dissolve the corporation and recover the payment stream when the bonds have been redeemed. The Legislative intent is to sell 77% of the MSA payments, reserving 13% for debt service on the OHSU bonds.

The table below shows the expected use of MSA payments beginning with the 2003-05 biennium. Undedicated amounts are available for Legislative appropriation.

Expected Sale or Use of MSA Payments

		Payments Sold		OHSU Debt	
Period*	Total	Payment	Residual	Service	Undedicated
2003-06	70.0	54.1	-	15.8	0.1
2006-07	70.9	54.1	43.3	15.8	44.3
2007-17	95.6	-	-	15.8	79.8
2017-23	93.5	-	-	15.8	77.7
2023-25	93.5	-	-	-	93.5

* Annual average shown for multiple fiscal years.